

LUXEMBOURG

Mighty micro-state flexes its muscles

As European integration moves ahead, the state intends to retain its influence, says Lionel Barber

Luxembourg is the mighty micro-state at the heart of Europe. A founder member of the European Union, it has exploited deftly the opportunities offered by open borders, free trade, and steady progress toward deeper political and economic integration.

The Grand Duchy's stability and prosperity is a source of admiration and occasional envy among its neighbours, so too, is the country's knack of turning one good idea into reality every 30 years, from modern steel-making, to private banking and the latest successful efforts to develop a cross-border life assurance industry.

Luxembourg's drive to diversify is moving ahead fast with the government-encouraged programme to build up a multi-media sector, partly to relieve some of the country's dependence on the financial sector which contributes LFR50bn (\$1.063bn) to the country's economy, roughly 35 per cent of gross domestic product.

Yet there are clouds drifting in from the Ardennes. The profitable banking industry is starting to complain about the high taxes and social costs needed to underpin Luxembourg's welfare state.

Unemployment figures have started to creep up. At 2.7 per cent, the jobless rate remains the lowest in the EU but it is still close to a post-second world war record. Traces of long-term unemployment are emerging for the first time in memory.

On the political front, the Grand Duchy is heading into next year's inter-governmental conference (IGC) with a degree of apprehension.

As the EU prepares to review

its power-sharing and constitutional rules ahead of the planned integration of central and eastern Europe around the turn of the century, there will be growing pressure to reduce the influence of smaller members, particularly mini-states such as Luxembourg.

Most observers believe that the Grand Duchy is fortunate to have a young, energetic and intelligent man in charge during this tricky period of transition. Jean-Claude Juncker took



Juncker determined to keep Luxembourg in the first division

over as prime minister last year aged 39, succeeding Jacques Santer who moved to Brussels as the new president of the European Commission to succeed Jacques Delors.

"Santer sent this country to sleep for 10 years, he was the man who could build a consensus," says an official who knows both prime ministers well. Another colleague agrees. "Santer concentrated on the issues that were most important, and never bothered much about the rest. He took the helicopter view."

By contrast, Mr Juncker comes across as a man in a hurry. As finance minister, a portfolio which he has

retained, he launched reforms of health insurance and in 1993 completed an overhaul of taxation, reducing the burden on middle-income and small to medium-sized companies, while keeping a tight grip on spending.

His latest target is civil service reform, a tough but necessary measure which has already brought him into conflict with the powerful public sector unions.

One of seven children of a steel-worker and trade union militant, Mr Juncker is a Christian Democrat with a strong sense of religion and a commitment to defending Europe's social model. Inside the EU club, he has a wealth of contacts and commands respect. Chancellor Helmut Kohl, a fellow Christian Democrat, viewing Mr Juncker as something of a protégé, refers to him affectionately as "Junior".

If Mr Juncker has a fault, it is that he is too much of a one-man show. But the young prime minister is determined to keep Luxembourg in the first division of EU member states, particularly in the run-up to the planned monetary union in 1999.

He lists his objectives as stable growth, balanced public finances, high rates of employment and price stability. The fact that Luxembourg is only one of three countries (the others are Germany and Ireland) which are judged by their peers to have met the Maastricht treaty's convergence criteria for European monetary union suggests that he and his country are on track.

Lucien Thiel, general manager of the Luxembourg Bankers Association, agrees that the figures look impressive. But he points to conflicting pressures facing the government as it seeks to prune public spending and reduce the tax burden in response to pressure from the corporate sector.

On the one hand, Mr Juncker is battling to rein in the ben-



efits of the civil service while not alienating one of the most important political constituencies. On the other, if he bows to the financial sector and lowers corporate taxes, he is bound to face calls to follow tradition and reduce the tax burden on private households by a corresponding amount.

"Juncker is showing a lot of courage tackling the problems today rather than storing up trouble for later," says a civil servant. "But if he gets it wrong, he could get into trouble."

A similar battle on pay and conditions is unfolding in the financial sector itself. Mr Thiel claims that union demands

combining a general pay increase, an automatic rise for seniority and a reduction in the working week from 40 to 35 hours, would produce a 40 per cent increase in costs over the next two years. "It's absolutely crazy," he says. "If there's to be an increase, it should only be for performance."

The unions dispute Mr Thiel's figures, but the outcome of the banking sector's pay round - which follows the expiry of an earlier three-year deal - will offer clues as to how serious Luxembourg is about keeping down its costs.

Long-time residents such as Fleming Fund Management have no doubt that the present

system of indexation has no place in a highly-developed service economy such as that of Luxembourg. "To have one's hands tied at salary review time is madness," says Tony Duggart, Fleming Fund Management's managing director.

The question is whether fear of unemployment will affect the negotiating climate. For although Luxembourg's jobless rate is low by EU standards, Mr Juncker's worst nightmare is that the country might start importing unemployment from outside its borders.

The Luxembourg economy draws heavily on skilled labour commuting in and out of the country, but as Mr Thiel points

KEY FACTS

Official title: The Grand Duchy of Luxembourg
Head of state: Grand Duke Jean of Luxembourg
Capital: Luxembourg-Ville
Area: 2,586 sq km
Population: 395,200 (1993)

Economic indicators	1990	1991	1992	1993	1994
GDP at market prices (Lfr bn)	352.8	377.5	406.3	432.6	455.3
Real GDP growth (%)	3.2	3.1	1.8	0.8	3.3
Consumer price inflation (%)	3.7	3.1	3.2	3.8	2.2
Population '000 (mid-year)	380	385	390	390	394
Exports fob-bn	6.3	8.3	6.5	5.8	8.4
Imports fob-bn	7.8	8.0	8.2	7.5	8.0
Exchange rate (av) Bfr/Lfr	33.4	34.2	32.2	34.6	33.5

Origin of gross domestic product 1992	% of total
Agriculture, viticulture and fishing	1.7
Manufacturing and mining	20.1
Energy and water	1.7
Construction	8.8
Services	67.6
GDP at factor prices	100.0

Components of gross domestic product 1994	% of total
Private consumption	53.3
Government consumption	13.5
Fixed investment	24.2
Stockbuilding	1.9
Exports of goods and services	88.5
Imports of goods and services	-80.6
GDP at market prices	100.0

Forecast summary (% change on previous year)	1993(a)	1994(a)	1995(b)	1996(b)
Real GDP	0.8	3.3	3.3	3.0
Industrial output(c)	-3.1	8.1	5.0	4.0
Crude steel production	7.0	-6.6	-10.0	10.0
Consumer prices	-3.6	2.2	2.2	2.5

(a) Actual (b) EU forecasts (c) Excluding steel
Source: EU Country Report and annex 1995, World of Information

out, freedom of movement could be double-edged. "There are 100,000 people out of work in the area known as the Big Region around Luxembourg, and we have permeable borders. This is a real problem," he says.

This is one reason why Mr Juncker is keen to ensure that social and employment policy is discussed properly at next year's IGC, particularly ahead of the planned move to monetary union.

To this end, Mr Juncker is taking advantage of the fresh spirit of co-operation with Belgium and the Netherlands which has developed under the leadership of Jean-Luc

Dehaene, the Belgian premier. The Benelux trio recognise the risks of a big power carve-up between France, Germany and the UK in 1996. Their calculation is that it is better to move in concert than go solo in Europe. Luxembourg's own strengths should not be underestimated.

From the 1970 Werner plan on monetary union, to the 1985 single European Act, as well as large chunks of the Maastricht treaty, a handful of resourceful political minds stamped Luxembourg's blend of consensus on the process of European integration. There is no reason to suspect that it will be any different the next time around.

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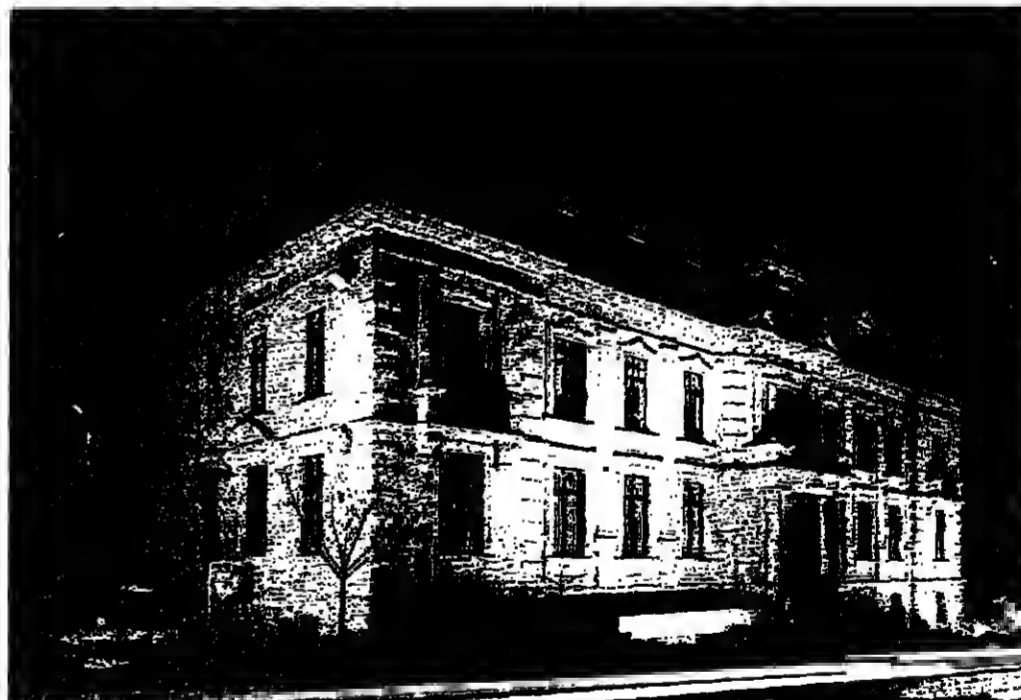
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Italy by David Lane

Outsiders get a cool reception

Recent months have been a hard test of patience for businessmen travelling by air within and to and from Italy. Delayed and cancelled flights have wreaked havoc on schedules, as, first, pilots of the Alitalia national airline and then air traffic controllers struck over pay demands. And while anarchy held sway at the airports, businessmen trying to contact offices and homes were dealing with a more efficient telephone system.

Italy does not have a good reputation for services and infrastructure. Neither during the 1990s, as the country's leaders lurched from one crisis to another, have politics received kind treatment from the media. Five different prime ministers have tenanted the Palazzo Chigi during the past 3½ years, and there are signs that a sixth will soon be in office. The corruption scandals that emerged in early 1992 continue to reverberate and political uncertainty badly affects the lira. Business people looking at Italy as a potential location for new ventures or with a view to expanding existing operations see instability and a situation that often appears incomprehensible.

Moreover, foreign companies

could be forgiven for believing that their presence is not really wanted. Italian officials and business people admit that there is a reluctance to accept outsiders. The notion that inward investment equals economic imperialism, often attributed to Italy's strong and vocal political left wing, has been hard to eradicate.

Aversion to foreigners is not confined to trade union leaders and left-wing politicians, however. Italy's own business people have been culpable. Many consider that automobile-maker Fiat did the country a disservice by preventing Ford from acquiring Alfa Romeo in 1986. The failure of the joint venture between Alfa Romeo and Nissan, established at the end of the 1970s, was also a setback for those who believe that greater internationalisation means welcoming more foreigners to Italy.

With a population of 57m, its position in the centre of the Mediterranean and membership of the European Union, Italy cannot be and has not been forgotten as a business location by foreigners. Indeed, a study published by the industrialists' confederation Confindustria in June, shows that there were 1,474 Italian manufacturing companies in which

foreigners had equity interests, either controlling or minority stakes, at the beginning of 1994. They provided jobs for nearly 500,000 people.

Confindustria's study shows that almost 225,000 jobs were in sectors with high economies of scale: food processing, household electrical appliances, primary chemicals, tyres and rubber products, and soaps, detergents and cosmetics. Although total numbers are low compared with other European countries, the spread of foreign interests in Italy is wide. Manufacturing companies in sectors of high technological intensity that have foreign ownership or equity stakes gave employment to nearly 126,000 in 1994. Pharmaceuticals headed the list with

41,300, followed by electronics and telecommunications with 39,200.

The US is the leading investor country. The 338 manufacturing companies with US parents or minority shareholders employed 151,700 at the beginning of 1994. The US chamber of commerce in Milan says that electronics, chemicals and pharmaceuticals are the main sectors. Manufacturing companies account, however, for less than half the total number of US concerns, whose overall investment in the chamber of commerce estimates at about \$15bn. There are around 250 US companies in services and finance and a similar number of sales operations.

New companies continue to arrive. Through its British subsidiary, Canada's Elcom Technology, a data communications hardware and software company, will establish an Italian operation at the beginning of next year. But, like many foreign companies in Italy, it will be a sales offshoot and modest in size. This is the problem that some Italian economists and businessmen are now beginning to recognise: Italy is failing to attract large new enterprises.

Much of foreign investment over recent years has been through acquisition of Italian companies. Confindustria's figures show that greenfield investments accounted for only 206,400 jobs in Italian manufacturing companies with foreign shareholders, just 14,800 being created between 1981 and 1993. The limited level of Japanese investment, only 700 new jobs between 1992 and 1994, confirms Italy's marginal position compared to other European countries.

Apart from the aversion factor, foreign investment is obstructed by the fragmented and uncertain official framework for attracting business to Italy. Two ministries are involved in providing incentives, the industry ministry for small and medium-sized enterprises and the budget ministry

for large companies. Italy's regional authorities also give incentives. Officials say that incentives legislation and administration, following the termination of special funding for the southern *mezzogiorno* regions, has not yet been fully settled.

Uncertainty over incentives is not new and is probably not as large a problem as Italy's failure to project an attractive image to potential investors.



Milan: foreigners have a share in 1,474 Italian manufacturing companies

Fragmentation of effort, inadequate resources and lack of coherent policy contribute to Italy's poor achievement in inward investment. Commercial work ranks low in Italian embassies around the world and the trade centres run by Istituto Nazionale per il Commercio Estero (INCE), whose own future is uncertain, are not geared up to encourage foreign investment in Italy.

In addition to the budget and industry ministries, a third, the foreign trade ministry, whose value is increasingly questioned, is involved in the task of tempting foreigners to locate in Italy. And the Istituto della Promozione Industriale (Industrial promotion institute), which is overseen by the industry ministry, also plays a part.

If everybody were to sing the same tune, Italy might do better in attracting investors.

Country	Company	Employees
US	338	151,700
France	254	94,784
Germany	208	58,544
Sweden	91	48,882
Switzerland	148	39,170
UK	183	37,584
Japan	53	18,284
Others	218	55,007
Total	1,474	487,126

Source: Confindustria

Austria

Gateway to the new democracies

Last August, Villach lost a close race against Newcastle as the location for Siemens's new microchip plant. But the feeling of disappointment remained muted. The fact that the southern Austrian town, where Siemens already operates a chip factory, came so close to winning the coveted prize speaks well for the qualities of the country as an investment location.

They include a highly skilled labour force, good infrastructure, and decades of macroeconomic stability. The disadvantages are high labour costs, strong trade unions and a plethora of labour regulations putting Austria in the category of high-cost countries.

The average industrial wage is Sch113 (\$11), but a series of fringe benefits required by law doubles the actual labour costs for

apprentice system that trains some of the best skilled workers anywhere in the world.

The geographical location is a mixed blessing. For decades, Austria was on the eastern edge of the capitalist world and remains quite far from the main business centres in western Europe. Still, the opening of the east has made Vienna an attractive gateway to the new democracies and has attracted new businesses. Road and train links are good, but rapid train lines are still years away.

Vienna's airport is growing quickly and the national airline, AUA, has established one of the best flight networks to the east. Telecommunication costs are high, but are slowly coming down. The postal service has a monopoly on all services,



Vienna: there are strict laws governing shop trading hours in Austria

employers. Most workers are organised in trade unions, and the Betriebsrat (employee council) has extensive rights in every large company. Weekends are generally work-free, and the unions have so far resisted the move toward flexible work hours that are common in other countries.

The most obvious example of the rigidity of conditions in Austria is the very strict shop-closing laws, which force all stores to close at 6.30 pm on weekdays and at 1 pm on most Saturdays. Sunday shopping is unheard of.

Driven by a high level of ecological consciousness, Austria has also tightened its environmental regulations in recent years. This has hurt the paper industry and other low-tech sectors, but may have accelerated structural changes in the economy. The strong trade unions and the culture of dialogue in Austrian business make relations between employers and workers the best in Europe.

Strikes are virtually unknown, and wage negotiations have been a civil affair even in tough times. On average, labour costs are 10 to 20 per cent lower in Austria than in neighbouring Germany, but the quality of the work force is equal. Like Germany, Austria has an

and the privatisation is held back by political resistance. A growing problem for some investors is Austria's tight immigration laws, which make it difficult to receive work permits even for highly skilled employees who do not come from an EU country.

Austria's entry into the European Union this year has helped to attract new foreign investments, even though the right to pay subsidies is now restricted by European regulations. The only region eligible for "Target One" subsidies by the EU is the eastern-most province of Burgenland. Some Swiss companies have relocated plants to western Austria.

Austrian government officials are particularly proud of the macroeconomic conditions. Inflation is 2.2 per cent, unemployment is 4 per cent, and the Austrian schilling has remained pegged to the German mark for decades. As other European currencies depreciated against the mark, however, Austria's export industry has been struggling to remain competitive.

Austria is also lagging other industrial countries in research and development outlays, which currently stand at 1.6 per cent of GDP.

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